**Franchise Tax Board**

# ANALYSIS OF AMENDED BILL

| | | | | | |
|---|---|---|---|---|---|
| Author: | Figueroa | Analyst: | Rachel Coco | Bill Number: | SB 1543 |
| Related Bills: | See Legislative History | Telephone: | 845-4328 | Amended Date: | June 16, 2004 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: FTB Notify California Tax Education Council Of Tax Preparers Who Violate Regulations/FTB May Cite, Levy, And Issue Cease & Desist Orders

## SUMMARY

This bill would do the following:

- require the Franchise Tax Board (FTB) to enforce the laws regulating Tax Preparers, and
- prevent an accountant or Tax Preparer from disclosing confidential client information unless the client consents in writing.

This bill also would make numerous other changes to the Business and Professions Code. This analysis will only discuss those provisions impacting FTB.

## SUMMARY OF AMENDMENTS

The June 14 and June 16, 2004, amendments would make various changes to the Business and Professions Code regarding tax professionals and California Tax Education Council (CTEC), as discussed in this analysis.

This is the department's first analysis of the bill.

## PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to protect confidential client information and to bring non-compliant Tax Preparers into compliance with existing law.

## EFFECTIVE/OPERATIVE DATE

The provisions of this bill relating to disclosure of information and to FTB enforcement would be effective and operative beginning January 1, 2005.

## POSITION

Pending.

| Board Position: | | | Department Director | Date |
|---|---|---|---|---|
| _______ S | _______ NA | _______ NP | | |
| _______ SA | _______ O | _______ NAR | Gerald H. Goldberg | 7/2/04 |
| _______ N | _______ OUA | ___X___ PENDING | | |

**ANALYSIS**

FEDERAL/STATE LAW

Federal law allows the Treasury Department to regulate the practice of tax professionals before the Internal Revenue Service (IRS). Administrative proceedings are brought against an individual who practices before the Internal Revenue Service or who violates the requirements of practice as required under federal law.

The office of the Director of Practice in the office of the Secretary of the Treasury approves applications for enrollment and oversees the practice of representatives before the IRS. The IRS does not oversee or regulate the practice of the representatives that come before them.

Certified Public Accountants (CPA) and attorneys are authorized to represent persons before the IRS. Others, such as enrolled agents and enrolled actuaries must apply for permission to practice before the IRS. The Director of Practice is responsible for enforcing the laws that regulate all individuals authorized to practice before the IRS and has the authority to begin administrative proceedings to disbar or suspend an individual in violation of those laws. A CPA, tax attorney, enrolled agent, or other professional who is suspended or disbarred is no longer allowed to practice in front of the IRS unless authorized by the Director of Practice.

Pending federal legislation (H.R. 1528) would, among other things, regulate federal Tax Preparers by requiring any Tax Preparer that files more than five federal tax returns annually to register with the Secretary of Treasury. Other provisions would provide that if an individual does not register, there would be a $500 fine per return filed.

Like the IRS, the primary purpose of FTB is to administer the tax laws. The FTB administers the California franchise and income tax laws.

State law defines a “Tax Preparer” as a person who for a fee, assists with or prepares state or federal tax returns for another person or who assumes responsibility for final completed work on a tax return.

Under state law, the Department of Consumer Affairs is the department established to regulate the various professions. Prior to the elimination of the Tax Preparer program (SB 1077 (Greene, Stats. 1996 Ch. 1137)) and the creation of CTEC, the Department of Consumer Affairs regulated Tax Preparers.

The responsibility for approving tax schools was transferred by the Legislature and the Governor from the State Tax Preparer program to CTEC effective July 1, 1997. CTEC was established to promote competent tax preparation within the State of California. CTEC is a private industry association comprised of a representative from each professional society, association, or other entity operating as a California nonprofit corporation that chooses to participate in the council and that represents Tax Preparers, enrolled agents, attorneys, or CPAs with a membership of at least 200 for the last three years. CTEC also may include not more than one representative from each for-profit tax preparation corporation that has been operating in California for the last three years.

Tax Preparers, other than CPAs, attorneys, or enrolled agents, are required to register with CTEC. CTEC is responsible for approving the curriculum of tax schools and certifying the education of Tax Preparers. CTEC has the authority to establish guidelines for Tax Preparers, including specific initial and continuing education requirements. Certified public accountants, members of the state bar, an employee of a trust, a financial institution regulated by the state and federal government, or enrolled agents practicing before the IRS are exempt from the requirements applicable to Tax Preparers.

The superior court in the county in which the Tax Preparer acts in violation of the chapter has jurisdiction to issue an injunction upon petition by any person. In addition, the violation of a Tax Preparer requirement is a misdemeanor, punishable by a fine up to $1,000 or imprisonment in county jail up to one year, or both.

Legislation enacted in 2002 authorized FTB to notify CTEC when an individual is identified who violates the registration requirement applicable to Tax Preparers. CTEC is then required to notify the Attorney General, a district attorney, or a city attorney of the violation. The government law enforcement agency notified has the authority to issue a citation and levy a fine not exceeding $1,000 for any violation of the requirements applicable to Tax Preparers. Those entities are also authorized to issue a cease and desist order, which shall continue in effect until the Tax Preparer registers.

The laws regulating the professional performance of Tax Preparers will cease to be operative July 1, 2008, and are repealed January 1, 2009.

<u>THIS BILL</u>

This bill would require, rather than allow, FTB to notify CTEC when it identifies individuals preparing tax returns who are not registered with CTEC. In addition, this bill would transfer the authority to enforce the penalties for violating the rules governing Tax Preparers from the government law enforcement agencies to FTB. Specifically, this bill would allow FTB to:

- cite individuals preparing tax returns in violation of the rules governing Tax Preparers,
- levy a fine on these individuals not to exceed $1,000 per violation, and
- issue a cease and desist order, effective until the Tax Preparer is in compliance with the registration requirement.

This bill also would, except in certain circumstances, prevent an accountant or Tax Preparer from disclosing confidential information concerning a client unless the client consents in writing.

<u>IMPLEMENTATION CONSIDERATIONS</u>

This bill would have a significant impact on the department. If FTB were authorized to regulate Tax Preparers, development of a new program, including possible additional equipment, education, staff, and other resources would be necessary to implement the provisions of this bill.

Under this bill, FTB would be required to enforce any violations of the rules regulating Tax Preparers. An example of a violation of the rules would include actions like failing to register as a Tax Preparer with CTEC or giving false or misleading information to CTEC. FTB administers the tax law; its expertise is not in the enforcement of the business and professions requirements of Tax Preparers.

In addition, the department notes the following concerns. Staff is available to work with the author's office to address these and any other concerns that may identified.

- The department currently captures information from tax returns regarding persons who prepare state tax returns. However, that information is not maintained on a database with the ability to track specific Tax Preparers. A new system would need to be developed to capture information from several different sources and cross-match that information to determine whether the preparer is subject to the state provisions that regulate Tax Preparers. In addition, the department would be need to track specific Tax Preparers who were in violation and determine when the preparer comes into compliance so that the cease and desist order can be removed

- While this bill would authorize the department to issue cease and desist orders, the bill lacks language that would provide any authority for enforcement of the orders. In addition, this bill would authorize FTB to levy a fine; however, the bill does not provide the authority for the department to take collection action against a Tax Preparer if the Tax Preparer failed to pay the fine. Thus, the department could levy a fine but would have no authority to collect it.

- While the bill provides that a fine may be levied against an individual who is in violation of the laws governing Tax Preparers, the bill does not specify how the fine should be assessed. For instance, it is unclear whether, in the case of an individual working in an office, whether the penalty would be assessed to the company he or she works for or to the individual..

- This bill lacks a timeframe for a Tax Preparer to comply with any remedial measures. As a result, a Tax Preparer could be immediately fined upon discovery of a violation. This could have a negative impact on the department's relationship with Tax Preparers and taxpayers.

- In addition, it appears that a Tax Preparer would be unable to protest or appeal a fine issued by FTB. Consequently, a Tax Preparer would not receive due process and would be unable to dispute an erroneous fine.

- Existing law permits CTEC to enter into an agreement with FTB to provide reimbursement of the expenses incurred in implementing provisions of existing law. This bill would make those provisions applicable to the reimbursement of FTB's expenses incurred in implementing this bill. However, due to the operative date of the bill and the lengthy process involved in agency agreements, the department would prefer a requirement for CTEC to reimburse FTB's costs in implementing this new responsibility. Thus, ensuring all departmental costs are covered. An appropriation should be added to this bill to provide FTB funding to begin a program as required by this bill. See Fiscal Impact below.

This bill would prohibit accountants and Tax Preparers from disclosing confidential client information, except under certain circumstances.

- This bill lacks a definition of "confidential client information." Consequently, it is unclear whether information that may be required by the department during audit would be considered "confidential" under this bill and thus unattainable.

- In addition, while the language does exclude disclosures made by a licensee in response to an official inquiry from a federal or state government regulatory agency, this exception fails to clearly permit disclosure to FTB. Currently, the department may contact an account or preparer that a taxpayer has designated as a power of attorney (POA). It is unclear whether the POA would be considered consent by the taxpayer under this bill. If not, the department would be required to obtain any necessary confidential taxpayer information from accountants or preparers using existing subpoena powers. In addition, judicial enforcement of routine subpoenas may become necessary if tax professionals construe this provision to prevent disclosure to tax agencies. As a result, this provision would have a significant impact to the department's audit and legal functions. .

The author may wish to amend the bill to specify what information would qualify as "confidential" and to clarify that state or federal taxing agencies would also be excluded from this provision.

## LEGISLATIVE HISTORY

SB 1955 (Stats. 2002, Ch. 1150) authorized FTB to notify CTEC when it encountered Tax Preparers that were not property registered. The bill requires CTEC to notify specific entities of the unregistered Tax Preparers and authorizes those entities to enforce the penalties set forth in the provision.

## FISCAL IMPACT

The department anticipates costs of approximately $1 million for the last six months of fiscal year 04/05 if this bill is effective January 1, 2005. These costs include staff to identify noncompliant Tax Preparers and handle additional telephone calls, instate travel, education and outreach and various one time systems costs. An appropriation should be added to this bill for the 2004/2005 costs of $1 million. Without an appropriation, the department may be unable to execute the requirements of this bill fully.

The department anticipates ongoing annual costs of approximately $2 million beginning with the 05/06 fiscal year to continue the activities described above, which the department would pursue in the course of the normal budgetary process.

## ECONOMIC IMPACT

Revenue Estimate

Although there is a potential for significant fines to be assessed, an estimate for the amount of fines collected annually cannot be quantified until the implementation considerations are resolved.

## ARGUMENTS/POLICY CONCERNS

By requiring FTB to enforce the rules governing Tax Preparers, this bill could have a negative impact on the positive relationship that currently exists between Tax Preparers and the department.

Since CTEC is responsible for enforcing the rules governing Tax Preparers, it may be more appropriate to allow CTEC the authority to issue the citations, fines, and orders provided for by this bill.

The authority to cite and fine Tax Preparers was recently granted to government law enforcement agencies, it seems premature to transfer the authority to FTB without sufficient time to evaluate the success or failure of the program.

Additional Comments

The department's fraud staff has an existing MOU with CTEC. Among other things, the MOU provides that when visiting unregistered Tax Preparers, FTB fraud staff provides them with information regarding CTEC. In addition, the MOU specifies that CTEC will provide financial support to FTB to continue the fraud team's field efforts.

## LEGISLATIVE STAFF CONTACT

Rachel Coco
Franchise Tax Board
845-4328
rachel.coco@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
brian.putler@ftb.ca.gov